

Annual Treasury Report 2016-17

1. Background

The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function at least twice a year (mid-year and at year end).

The Council's Treasury Management Strategy for 2016/17 was approved by the Council on 16 February 17 (Minute No. 991refers).

The Council has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers treasury activity and the associated monitoring and control of risk.

2. Economic Background provided by Arlingclose

Economic background: Politically, 2016/17 was an extraordinary twelve month period which defied expectations when the UK voted to leave the European Union and Donald Trump was elected the 45th President of the USA. Uncertainty over the outcome of the US presidential election, the UK's future relationship with the EU and the slowdown witnessed in the Chinese economy in early 2016 all resulted in significant market volatility during the year. Article 50 of the Lisbon Treaty, which sets in motion the 2-year exit period from the EU, was triggered on 29th March 2017.

UK inflation had been subdued in the first half of 2016 as a consequence of weak global price pressures, past movements in sterling and restrained domestic price growth. However the sharp fall in the Sterling exchange rate following the referendum had an impact on import prices which, together with rising energy prices, resulted in Consumer Price Index (CPI) rising from 0.3% year/year in April 2016 to 2.3% year/year in March 2017.

In addition to the political fallout, the referendum's outcome also prompted a decline in household, business and investor sentiment. The repercussions on economic growth were judged by the Bank of England to be sufficiently severe to prompt its Monetary Policy Committee (MPC) to cut the Bank Rate to 0.25% in August and embark on further gilt and corporate bond purchases as well as provide cheap funding for banks via the Term Funding Scheme to maintain the supply of credit to the economy.

Despite growth forecasts being downgraded, economic activity was fairly buoyant and Gross Domestic Product (GDP) grew 0.6%, 0.5% and 0.7% in the second, third and fourth calendar quarters of 2016. The labour market also proved resilient, with the International Labour Organisation (ILO) unemployment rate dropping to 4.7% in February, its lowest level in 11 years.

Following a strengthening labour market, in moves that were largely anticipated, the US Federal Reserve increased rates at its meetings in December 2016 and March 2017, taking the target range for official interest rates to between 0.75% and 1.00%.

Financial markets: Following the referendum result, gilt yields fell sharply across the maturity spectrum on the view that Bank Rate would remain extremely low for the foreseeable future. After September there was a reversal in longer-dated gilt yields which moved higher, largely due to the MPC revising its earlier forecast that Bank Rate would be dropping to near 0% by the end of 2016. The yield on the 10-year gilt rose from 0.75% at the end of September to 1.24% at the end of December, almost back at pre-referendum levels of 1.37% on 23rd June. 20- and 50-year gilt yields also rose in Q3 2017 to

1.76% and 1.70% respectively, however in Q4 yields remained flat at around 1.62% and 1.58% respectively.

After recovering from an initial sharp drop in Q2, equity markets rallied, although displaying some volatility at the beginning of November following the US presidential election result. The Financial Times Stock Exchange (FTSE)-100 and FTSE All Share indices closed at 7342 and 3996 respectively on 31st March, both up 18% over the year. Commercial property values fell around 5% after the referendum, but had mostly recovered by the end of March.

Money market rates for overnight and one week periods remained low since Bank Rate was cut in August. 1- and 3-month London International Bid Rate (LIBID) rates averaged 0.36% and 0.47% respectively during 2016-17. Rates for 6 and 12-months increased between August and November, only to gradually fall back to August levels in March, they averaged 0.6% and 0.79% respectively during 2016-17.

Credit background: Various indicators of credit risk reacted negatively to the result of the referendum on the UK's membership of the European Union. UK bank credit default swaps saw a modest rise but bank share prices fell sharply, on average by 20%, with UK-focused banks experiencing the largest falls. Non-UK bank share prices were not immune, although the fall in their share prices was less pronounced.

Fitch and Standard & Poor's downgraded the UK's sovereign rating to AA. Fitch, Standard & Poor's (S&P) and Moody's have a negative outlook on the UK. Moody's has a negative outlook on those banks and building societies that it perceives to be exposed to a more challenging operating environment arising from the 'leave' outcome.

None of the banks on the Authority's lending list failed the stress tests conducted by the European Banking Authority in July and by the Bank of England in November, the latter being designed with more challenging stress scenarios, although Royal Bank of Scotland was one of the weaker banks in both tests. The tests were based on banks' financials as at 31st December 2015, 11 months out of date for most. As part of its creditworthiness research and advice, the Authority's treasury advisor Arlingclose regularly undertakes analysis of relevant ratios - "total loss absorbing capacity" (TLAC) or "minimum requirement for eligible liabilities" (MREL) - to determine whether there would be a bail-in of senior investors, such as local authority unsecured investments, in a stressed scenario.

On the advice of Arlingclose, new investments with Deutsche Bank and Standard Chartered Bank were suspended in March 2016 due to the banks' relatively higher credit default swap (CDS) levels and disappointing 2015 financial results. Standard Chartered was reintroduced to the counterparty list in March 2017 following its strengthening financial position, but Deutsche Bank was removed altogether from the list.

Local Context

At 31/03/2017 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was zero.

At 31/03/2017, the Council had no borrowing and £11.5m of investments. The Council may however have to borrow to pre fund future years requirements or unexpected capital expenditure that occurs in the year providing this does not exceed the authorised limit for borrowing of £10m.

The Council is currently debt free and its capital expenditure plans do not currently imply any need to borrow over the forecast period. Investments are forecast to fall to £7.8m as capital receipts are used

to finance capital expenditure and reserves are used to finance the revenue budget over the next three years.

Investment Activity in 2016 / 17

Investments	Balance on 01/04/2015 £'000	Investments Made £'000	Maturities/ Investments Sold £'000	Balance on 31/03/2017 £'000
Short term fixed Investments **	3,000	2,000	3,000	2,000
Cash Accounts	1,005	1,000	5	2,000
Money Market Funds	0	45,400	42,900	2,500
Certificates of Deposit	4,000	8,000	10,000	2,000
LAMIT Property Fund	3,000			3,000
TOTAL INVESTMENTS	11,005			11,500
Increase/ (Decrease) in Investments £m				500

** The Short Term fixed Investment outstanding at 31 March 2017 was as follows

Borrower	Amount £'000	Maturity Date
Lloyds	2,000	10 August 2017

Security of capital has remained the Council's main investment objective. This has been maintained by following the Council's counterparty policy as set out in its Treasury Management Strategy Statement for 2016/17.

Compliance Report

All treasury management activities undertaken during 2016/17 complied fully with the CIPFA Code of Practice and the Authority's approved Treasury Management Strategy.

The council continues to be debt free so compliance with the authorised limit and operational boundary for external debt is confirmed.

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Interest Rate Exposures: This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net interest payable, should borrowing become necessary, would be:

APPENDIX A

	31.3.17 Actual	2016/17 Limit	Complied
Upper limit on fixed interest rate exposure	0	100%	✓
Upper limit on variable interest rate exposure	0	100%	✓

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

Maturity Structure of Borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing, should borrowing become necessary, would be:

	31.3.17 Actual	Upper Limit	Lower Limit	Complied
Under 12 months	0%	100%	0%	✓
12 months and within 24 months	0%	100%	0%	✓
24 months and within 5 years	0%	100%	0%	✓
5 years and within 10 years	0%	100%	0%	✓
10 years and above	0%	100%	0%	✓

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 364 days: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

	2016/17	2017/18	2018/19
Limit on principal invested beyond year end	£1m	£1m	£1m

There were no investments made beyond 364 days in 2016/17

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment.

	Target	Actual
Portfolio average credit score	6	3.83

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	Target	Actual
Total cash available within 3 months	£3m	£4.5m

Investment Training

The needs of the Council's treasury management staff for training in investment management are assessed as part of the staff appraisal process and additionally when the responsibilities of individual members of staff change.

During 2016/17 staff attended training courses, seminars and conferences provided by Arlingclose. Training was also provided to Members by Arlingclose at the Council offices in March 2017.